Harlequin Enterprises Limited

Annual Report 1978

CONTENTS

HIGHLIGHTS

	% INCREASE	1978	1977
Revenues ($000)	56%	**$125,866**	$80,451
Net Earnings ($000)	34%	**$ 16,791**	$12,514
Earnings per Share	34%	**$ 1.06**	$ .79
Equity per Share	48%	**$ 2.85**	$ 1.93

ANNUAL MEETING

The 1979 Annual Meeting of Shareholders will be held in the Governor General's Suite, at the Hotel Toronto, 145 Richmond Street West, Toronto, at 10:00 a.m., May 17, 1979. We hope you will attend the meeting.

Harlequin Enterprises Limited– An Overview

Harlequin is an international publishing organization best known for its romantic fiction, a special kind of literature that provides entertainment for millions of women throughout the world. The Company's publications, under a number of imprints, including Harlequin and Mills & Boon, are sold in over 80 countries and published in 15 different languages.

Harlequin is also engaged through subsidiary companies in the publication of consumer magazines in North America, and general and educational non-fiction in the United Kingdom and overseas markets. In addition, Harlequin also distributes learning materials and books in Canada and publishes Canadian educational products.

Future developments will include continued growth in fiction publishing, additional magazine publishing ventures and diversification into related product areas.

PRESIDENT'S MESSAGE

The year 1978 saw continued growth and expansion of our business. This would be good news to share with you in any year, but I am particularly pleased to share it with you this year as we approach our 30th Anniversary.

From modest beginnings in Winnipeg in 1949, Harlequin has grown to become a multinational publishing house.

In the early years, the business experienced some difficulty as the founders struggled to identify books that would find favour with readers. They succeeded admirably, as the record attests. Ever since, management has remained attuned to the interests of our readers and how they might best be served.

Harlequin, like other book publishers, is essentially a middleman between authors and readers. We guide authors through our editors and we strive for the widest possible international readership for their literary work.

Because we have chosen to concentrate our endeavours in the general area of light entertainment, we have been unhampered by the need for critical literary acclaim. Rather, we have centred our attentions single-mindedly on readers, who are the real critics of our publications.

Our practice of marketing books under imprints, or brand names, carries with it the assurance that readers will find consistent enjoyment from book to book in the ongoing series.

Imprint marketing also provides substantial benefits for our authors. It allows new authors to be introduced into series where they can enjoy immediate success. It permits the use of advertising support at levels not possible for the works of individual authors, to the benefit of all. At the same time, imprint marketing does not inhibit reader recognition of particular authors' styles nor appreciation of their special skills.

As long as we continue to be attentive to the interests of both our readers and our authors, we believe that prosperity will continue to attend the Company's future.

Standing, right to left: Richard A. N. Bonnycastle; William F. Willson; Richard H. Bellringer; Carlo Vittorini.

Seated, right to left: Alan W. Boon; W. Lawrence Heisey; John T. Boon.

REPORT TO SHAREHOLDERS

In 1978, Harlequin again set new sales and earnings records. Consolidated revenues reached $125,866,000, a 56% increase over 1977, while net earnings rose 34% to $16,791,000. Earnings per share increased to $1.06 from $0.79 last year.

Contributing to these results were unit sales growth in all of the Company's major markets, continued expansion of the publishing program in Europe, and the acquisition of the Laufer group of magazines. Earnings also benefited from the full effect of price increases initiated in 1977 and foreign exchange gains due to the reduced value of the Canadian dollar.

Upon passing the $100 million sales mark, it is worth noting the Company's performance over the past eight years. Since 1970, revenues have grown from $7.7 million to $125.9 million–a compound growth rate of 41.8%. During the same period, net earnings have increased from $0.1 million to $16.8 million and total romance books sold from 19 million to 125 million.

During 1978, Harlequin continued to strengthen its position in the North American paperback market. Publishing activities were extended to include two new series, *Harlequin Historicals* and *Collection Harlequin,* a line of French-language romantic fiction introduced in Quebec in June with immediate market acceptance. A new imprint, *Worldwide Books,* was established in 1978 to provide identification for specific new products developed by Harlequin Books. *Mystique Books,* a series of romantic suspense paperbacks scheduled for release in early 1979, will be the first venture to carry the *Worldwide* imprint.

The Harlequin Overseas Group enjoyed a year of development and expansion. The established companies in the United Kingdom, Australia, West Germany and Holland all performed successfully. Harlequin France launched its *Collection Harlequin* in April, 1978, and at year end the prospects look most encouraging. Considerable research, which was carried out in other markets, has resulted in plans to start operations in Mexico and Scandinavia in 1979.

In April, 1978, we undertook a diversification into the magazine business through the acquisition of 78% of The Laufer Company. The purchase price was approximately U.S. $9,300,000. Based in Hollywood, Laufer is a leading publisher of teenage and adult entertainment magazines, including *Tiger Beat, Right On!,* and *Rona Barrett's Hollywood.* We welcome the company's President, Charles Laufer, and his associates to Harlequin.

Harlequin Magazines Inc. was established later in the year in New York. It will be the focal point of our commitment to seek a significant presence in the North American magazine industry. This new division is headed by Carlo Vittorini who, prior to joining Harlequin, was President of The Charter Publishing Company and Publisher of Redbook Magazine. *Texas Woman,* a regional life-style magazine published by a new subsidiary, Paragon III Associates, has been launched and other attractive opportunities are being examined.

Since 1975, Harlequin has assisted the Canadian Authors Association by funding its annual literary awards in the fields of fiction, non-fiction, poetry and drama. Judged the best novel in 1977 was Jane Rule's *The Young in One Another's Arms,* published by Doubleday. In the non-fiction category the winning book was *The Stress of My Life,* by Hans Selye, published by McClelland & Stewart. Alden Nowlan's volume, *Smoked Glass,* published by Clark Irwin, won the poetry award, and the two-act play, *Boiler Room Suite,* by Rex Deverell, published by Playwrights Co-op, was judged the winner in the drama category.

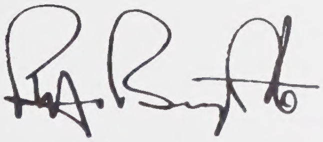
Harlequin's corporate objectives are to continue to increase the development of English-language markets for romantic fiction, to develop and expand publishing activities in other languages, and to acquire businesses in related areas that will capitalize on the Company's publishing, marketing and distribution skills. Important steps were taken in 1978 in all these areas.

Subsequent to the year end, William F. Willson and Richard H. Bellringer were appointed Executive Vice-Presidents of Harlequin. Both Mr. Willson and Mr. Bellringer have been instrumental to the Company's growth since 1970.

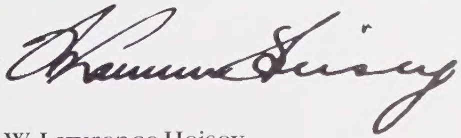
Looking ahead, we are confident that the strength and resources of the Company, which have brought about consistent progress in the past, will enable us to sustain a healthy rate of growth in the future.

Our achievements in 1978 bear the mark of the imagination and dedication of our employees around the world. We are grateful for their outstanding efforts.

On behalf of the Board



Richard A. N. Bonnycastle



W. Lawrence Heisey

NET REVENUES ($000)

1970	$ 7,719
1971	$ 7,977
1972	$ 15,277
1973	$ 20,358
1974	$ 30,983
1975	$ 43,249
1976	$ 52,391
1977	$ 80,451
1978	$125,866

NET EARNINGS ($000)

1970	$ 110
1971	$ 454
1972	$ 1,577
1973	$ 2,737
1974	$ 3,527
1975	$ 4,418
1976	$ 5,323
1977	$ 12,514
1978	$ 16,791

EARNINGS PER SHARE

1970	$ .01
1971	$ .04
1972	$ .12
1973	$ .18
1974	$ .24
1975	$ .29
1976	$ .34
1977	$ .79
1978	$ 1.06

EQUITY PER SHARE

1970	$ .31
1971	$ .34
1972	$ .46
1973	$ .61
1974	$ .79
1975	$ .97
1976	$ 1.23
1977	$ 1.93
1978	$ 2.85

DIVIDENDS DECLARED ($000)

1972	$ 114
1973	$ 413
1974	$ 991
1975	$ 1,227
1976	$ 1,316
1977	$ 1,397
1978	$ 2,346

ROMANCE BOOKS SOLD BY HARLEQUIN COMPANIES
Millions of Books—Net

1969	17
1970	19
1971	25
1972	29
1973	42
1974	63
1975	72
1976	90
1977	109
1978	125


Betty Neels
Elizabeth Hoy
Amanda Doyle
Violet Winspear

HARLEQUIN BOOKS

My moments with Harlequin are special and very personal...

Harlequin Books, the Company's North American publishing arm, again achieved substantial growth in 1978. The continuation of strong marketing efforts, new product introductions and effective media support, all contributed to record operating results.

New publishing activities received particular emphasis during the year. *Harlequin Historicals,* which were tested in 1977, were introduced in February, 1978. In June, a new line of French-language romantic fiction, *Collection Harlequin,* was launched in Quebec on a four-title-per-month basis. The initial results indicate excellent market acceptance. In addition, the *Harlequin Omnibus* series, offering three novels by the same author in each book, was successfully reintroduced for retail sale.

Complementing these programs was the company's first single-author promotion under the caption *Harlequin Salutes...,* featuring the works of Roberta Leigh. Another introduction in 1978 was *The Warrender Saga* by Mary Burchell, a collection of nine romances chronicling the lives of two of the best known characters created by this popular Harlequin author.

In 1978, Harlequin Books announced the formation of a new imprint, *Worldwide Library,* which will be used to identify specific new products. The first venture to carry the new imprint will be *Mystique Books,* scheduled for release in March, 1979. Adapted from a successful line of French novels, the Mystique series will be the first romantic suspense paperbacks to be marketed as a continuing series in North America. Eight titles will be published initially, followed by four new titles each month. The launch will be supported by a major advertising budget allocated primarily to network television commercials and augmented by mass media publicity.

Harlequin romances make me feel young again...

"No matter how full and happy life might be, it is an enchantment to sit and read your novels."

D. K., WILLOWDALE, ONTARIO

"Harlequins have been my passport to the world. I have been many places without leaving my doorstep."

P. Z., BELVEDERE, ILLINOIS

"Thank you for bringing romance back to me."

J. W., TEHACHAPI, CALIFORNIA

"I can't imagine my reading life without Harlequin."

J. L., SIOUX FALLS, SOUTH DAKOTA

"I can think of no better way of relaxing than with a Harlequin. They allow me to face my world with a smile and new confidence."

L. F., AMES, IOWA

HARLEQUIN BOOKS

Extensive research and continued monitoring of marketing programs are an integral part of the company's success. Not only do they form the basis for new product development, but they also enable the company to effectively respond to new trends and consumer demands.

Starting with the May, 1979, releases, the publishing schedule will be changed from eight *Romances* and four *Presents* per month to six titles each per month. At the same time the cover price of the *Romances* will be raised from $0.95 to $1.25 and the *Presents* from $1.25 to $1.50. Despite these increases, Harlequin books still continue to be priced substantially lower than the average paperback.

Because Harlequin books are purchased by imprint rather than by title or author, they can essentially be promoted as a single product. Advertising has played a significant part in increasing public awareness and readership. In February, 1979, an aggressive advertising program was undertaken on daytime and prime-time television in the United States and Canada. The campaign features three 30-second advertisements, which will be shown on over 360 stations in North America.

A national retail sales organization was formed in late 1977 to assume responsibility for Canadian sales representation. Previously, this had been handled through a joint venture with another mass market publisher. The transition was completed in 1978, with management's expectations for the new operation being fully realized. In the United States, sales representation is handled by Pocket Books Distribution Corp., a division of Simon & Schuster. The effort of these two organizations is augmented by Harlequin Reader Service, which plays an important role in providing access to consumers not directly served through regular trade channels.

The Book Division's operations also include Ideals Publishing Corporation, best known for its inspirational magazines and related hard- and soft-cover books, and Jonathan-James Books, which specializes in the field of international book packaging.

Ideals Publishing was completely restructured during the year. Management has been strengthened and a new focus brought to bear on the company's marketing and publishing programs, thereby laying the groundwork for renewed growth in the future.

Jonathan-James Books completed a successful year, developing and selling seven new titles, all of which have been well received in the international marketplace.

HARLEQUIN OVERSEAS GROUP

Harlequin romances take me to places I've always dreamed about...

Harlequin is aggressively developing and expanding business opportunities overseas, with operating companies in the United Kingdom, Australia, France, Holland and West Germany. In 1979 the Company plans to establish new operations in Mexico, Scandinavia, and Greece. Extensive research continues into these and other markets.

UNITED KINGDOM

Mills & Boon Limited, London, is the basic editorial source of Harlequin's romantic fiction series, publishing fourteen hardcover titles per month. These titles and the company's backlist form the basis of the Mills & Boon paperback series, which are published in the United Kingdom and exported to operations in Australia and New Zealand, as well as to independent distributors in some 90 other countries. The hardcover titles are also the source of the Harlequin series published in North America, and are translated into most major languages for Harlequin companies operating in markets around the world. In addition, Mills & Boon publishes general and educational books on a wide range of subjects.

1978 was a year of strong growth for Mills & Boon. Romance sales increased substantially, while higher profit margins and general cost controls produced record earnings. These increases were linked with the most extensive advertising campaign yet undertaken by the company.

During the year, Mills & Boon launched the new *Masquerade* historical romance series with an initial program of two titles a month. The response has been most encouraging.

Bringing the romance of distant settings to readers around the world...

"I am taken away to a world of romance and see so many beautiful places in your books. Never before have I had such pleasure from reading."

J. P., WIGAN, ENGLAND

"The appeal of your romances is timeless."

M. J., VICTORIA, AUSTRALIA

"I enjoy your books the more I read them...they have that touch of 'something special.'"

N. T., MANILA, PHILIPPINES

"You bring me endless hours of pleasure. Romance, excitement, humour, intrigue, travel–it's all there in your novels."

E. B., FRANKFURT, GERMANY

"While in a hurry at the airport I literally grabbed the nearest paperback to read on the plane....Soon I was spinning through one of the most delightful and tingling novels that I have ever read."

E. S., SUVA, FIJI

Harlequin romances remind me of what it was like to be in love for the first time...

HARLEQUIN OVERSEAS GROUP

UNITED KINGDOM (cont'd)
In the Non-Fiction Division, progress was made in rationalizing and replanning the product list and marketing arrangements. New publishing and selling programs are planned for 1979.

Finally, Marshall Editions, a subsidiary company specializing in international co-edition publishing, produced its first three books, all of which have been well received.

AUSTRALIA

Mills & Boon Pty. Ltd. performed extremely well in 1978. The company has established itself as one of the foremost paperback marketers in Australia, with consistently higher unit growth than the industry average.

During 1978, consumer television advertising was successfully tested in Sydney and Melbourne. This will form the basis of a national campaign in 1979. Progress was also made with the introduction of the new *Masquerade* historical romances, adding a further dimension to the company's existing product lines.

FRANCE

In April, 1978, Harlequin S.A. of Paris launched its *Collection Harlequin* series with four titles a month. Aimed at the French, Belgian and Swiss markets, and supported by extensive national print and radio promotions, the books received immediate acceptance. In January, 1979, the publishing schedule was increased to six titles a month.

Performance to date has been in line with management's expectations and there is every indication that France will make a substantial contribution to the Company in the near future.

HOLLAND

Harlequin Holland's results for the year were excellent. The established romance lines, *Bouquet Reeks* and *Jasmijn,* enjoyed major increases in unit sales and profits, and a new series, *Bouquet Reek Historicals,* was launched in April, 1978. In addition, the editorial and marketing strategies were developed for two new introductions in 1979–*Bianca,* a romance series with a medical setting, and *Baccara,* a romantic suspense series.

GERMANY

In spite of the emergence in 1978 of a competitive line of romances, operating results in West Germany forged ahead. This performance reflects the overall strength and editorial quality of the three basic romance series, *Julia, Romana,* and *Bianca,* and the distribution and promotional skills of our joint venture partner, Axel Springer Verlag AG, the country's largest newspaper and magazine publisher.

In 1979, publishing activities will be expanded to include a new romantic suspense series under the *Baccara* imprint.

THE LAUFER COMPANY

People and personalities in the news.

In April, 1978, Harlequin acquired, through a public tender offer, an approximate 78% interest in The Laufer Company. A further 21% of the shares, held by senior Laufer officers, is subject to a purchase agreement with Harlequin over a five-year period.

The company, which was founded by Charles Laufer in Hollywood in 1965, is recognized as the leading publisher of entertainment magazines and related material for the teenage and adult market in North America. Currently eight magazines, under such titles as *Tiger Beat, Right On!* and *Rona Barrett's Hollywood,* are published monthly, complemented by various annual and special editions. The magazines receive wide newsstand distribution and are also sold on a subscription basis. During 1978, the circulation for the adult group of titles was approximately 900,000 copies per month, while for the teenage group the monthly circulation was just under 1,200,000 copies.

Laufer's Hollywood location, which puts it at the heart of the entertainment industry, combined with an experienced editorial staff and extensive in-house photographic facilities, provides the company with the ability to spot and capitalize on trends in the industry.

During the year, the company undertook a number of steps to strengthen its position and lay the foundation for future growth. A new sales representation arrangement in the United States was signed with The Independent News Company. New promotional and marketing programs aimed at increasing circulation were introduced, including the use of checkout racking. In addition, progress was made in attracting national advertising.

Product development continues to be a focus of attention in the company, with several new prospects currently under review for future introduction. Opportunities in Europe, either through the export market or direct participation, are also being considered.

HARLEQUIN FILM DIVISION

Translating our success into other media.

1978 saw the release of Harlequin's first feature film, *Leopard in the Snow*. Based on the Mills & Boon/Harlequin novel of the same title by Anne Mather, the film received distribution in several North American and foreign markets including the United Kingdom, Japan, Australia, Israel, Greece, South Africa, New Zealand, Ireland, the West Indies and the U.S.S.R. The realease was successfully tied in with a reissue of the book.

The box office results of the film release have been somewhat inconsistent; further testing is being undertaken to determine the feasibility of profitably exploiting the Company's extensive line of romantic fiction through the production of theatrical films.

In addition to feature films, the company is developing material based on its overall backlist for the international television market.

SCHOLAR'S CHOICE LIMITED

Educational products to challenge and stimulate young minds.

Scholar's Choice is a major supplier of learning and resource materials to the Canadian educational market. The company is a national distributor, supplying more than 25,000 items, including learning materials, supplies and equipment, film strips and library books to schools and teachers in every province.

Based in Stratford, Ontario, the company markets its products through a catalogue program complemented by sales personnel located throughout Canada. In addition, a Personal Shopping Centre in Vancouver provides teachers and librarians the opportunity to select and purchase materials in person.

The concept of bringing educational products closer to not only teachers, but also parents and students, was introduced in 1977 with the establishment of a retail store in Toronto. During 1978, a second retail outlet was opened in Toronto.

Scholar's Choice continues to expand its publishing program with an emphasis on inexpensive educational materials in major subject areas.

Harlequin Enterprises Limited
(Incorporated under the laws of Canada)

CONSOLIDATED BALANCE SHEET (thousands of dollars)
December 31, 1978 *(with comparative figures at December 31, 1977)*

		1978	1977
ASSETS	CURRENT ASSETS:		
	Cash and short-term notes	**$22,534**	$24,000
	Accounts receivable *(note 3)*	**17,606**	8,609
	Inventories, at the lower of cost and net realizable value	**10,687**	8,376
	Prepaid expenses and other current assets	**4,172**	2,605
	Prepaid income taxes *(note 1)*	**3,370**	2,287
	Total current assets	**58,369**	45,877
	FIXED ASSETS, at cost *(note 4)*	**3,879**	2,792
	Less accumulated depreciation	**1,585**	1,076
	Net fixed assets	**2,294**	1,716
	GOODWILL *(note 1)*	**14,133**	6,367
		$74,796	$53,960

On behalf of the Board:

Director

Director

(See accompanying notes to consolidated financial statements)

LIABILITIES AND SHAREHOLDERS' EQUITY

	1978	1977
CURRENT LIABILITIES:		
Accounts payable and accrued charges	$16,904	$11,153
Income taxes payable	5,812	9,392
Dividend payable	1,586	712
Current portion of long-term debt	913	
Total current liabilities	25,215	21,257
Long-term debt *(note 5)*	3,380	2,171
Minority interest in subsidiary	1,009	
SHAREHOLDERS' EQUITY:		
Capital stock *(note 6)*		
Authorized: 27,000,000 common shares without nominal or par value		
Issued: 15,860,829 shares (1977–15,825,624 shares)	4,432	4,217
Retained earnings	40,760	26,315
	45,192	30,532
	$74,796	$53,960

AUDITORS' REPORT

To the Shareholders of
Harlequin Enterprises Limited:

We have examined the consolidated balance sheet of Harlequin Enterprises Limited as at December 31, 1978 and the consolidated statements of earnings and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Canada,
February 26, 1979.

Clarkson, Gordon & Co.
Chartered Accountants

CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS (thousands of dollars)

For the year ended December 31, 1978 *(with comparative figures for 1977)*

		1978	1977
EARNINGS	GROSS INCOME	**$125,866**	$80,451
	EARNINGS FROM OPERATIONS BEFORE THE FOLLOWING	**$ 31,479**	$24,156
	Deduct (add):		
	Exchange adjustment *(note 1)*	**(446)**	(415)
	Depreciation	**506**	245
	Interest income	**(1,304)**	(745)
	Minority interest in earnings of subsidiary	**287**	
	EARNINGS BEFORE INCOME TAXES	**32,436**	25,071
	Income taxes	**15,645**	12,557
	NET EARNINGS FOR THE YEAR	**$ 16,791**	$12,514
	NET EARNINGS PER SHARE *(note 7)*	**$1.06**	$ 0.79

RETAINED EARNINGS	RETAINED EARNINGS, BEGINNING OF YEAR	**$ 26,315**	$15,198
	NET EARNINGS FOR THE YEAR	**16,791**	12,514
		43,106	27,712
	DIVIDENDS DECLARED (per share, 1978–$0.148, 1977–$0.088)	**2,346**	1,397
	RETAINED EARNINGS, END OF YEAR	**$ 40,760**	$26,315

(See accompanying notes to consolidated financial statements)

CONSOLIDATED STATEMENT
OF CHANGES IN FINANCIAL POSITION (thousands of dollars)
For the year ended December 31, 1978 *(with comparative figures for 1977)*

	1978	1977
SOURCE OF FUNDS:		
Net earnings for the year	$16,791	$12,514
Add–		
Depreciation	506	245
Amortization of goodwill	219	64
Minority interest in earnings of subsidiary	287	
Funds from operations	17,803	12,823
Proceeds of long-term debt	2,122	694
Capital stock issued	215	56
Total funds provided	20,140	13,573
APPLICATION OF FUNDS:		
Acquisition of subsidiary *(excluding net current assets)*		
Goodwill	7,985	681
Fixed assets	102	295
	8,087	976
Less minority interest *(1977–long-term debt)*	722	950
	7,365	26
Reduction in long-term debt	913	
Dividends	2,346	1,397
Fixed assets	982	649
Total funds applied	11,606	2,072
INCREASE IN WORKING CAPITAL	8,534	11,501
WORKING CAPITAL, BEGINNING OF YEAR	24,620	13,119
WORKING CAPITAL, END OF YEAR	$33,154	$24,620
CHANGES IN COMPONENTS OF WORKING CAPITAL:		
Increase (decrease) in current assets–		
Cash and short-term notes	$(1,466)	$15,081
Accounts receivable	8,997	3,096
Inventories	2,311	2,822
Prepaid expenses and other current assets	1,567	1,416
Prepaid income taxes	1,083	689
	12,492	23,104
Increase (decrease) in current liabilities–		
Accounts payable and accrued charges	5,751	3,753
Income taxes payable	(3,580)	7,822
Dividend payable	874	28
Current portion of long-term debt	913	
	3,958	11,603
INCREASE IN WORKING CAPITAL	$ 8,534	$11,501

(See accompanying notes to consolidated financial statements)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1978

1. Summary of significant accounting policies

(a) **BASIS OF CONSOLIDATION**–The accompanying consolidated financial statements consolidate the accounts of Harlequin Enterprises Limited and its subsidiaries, all of which are wholly-owned except The Laufer Company (78%). In addition, the Company includes its pro rata share of the assets, liabilities, income and expenses of an investment in a joint venture. Its principal subsidiaries are:

Mills & Boon Limited–Britain
Mills & Boon Pty. Limited–Australia
Harlequin S.A.–France
Harlequin Enterprises B.V.–The Netherlands
Harlequin Enterprises GmbH–West Germany
Scholar's Choice Limited–Canada
Harlequin Books Incorporated–U.S.A.
Ideals Publishing Corporation–U.S.A.
The Laufer Company–U.S.A.

All acquisitions have been accounted for using the purchase method of accounting with the Company's share of earnings being included from dates of acquisition.

(b) **EXCHANGE TRANSLATION**–Accounts denominated in foreign currencies have been translated to Canadian dollars as follows: current assets and liabilities (other than those covered by foreign exchange contracts) at exchange rates prevailing at December 31, 1978; fixed assets, goodwill, depreciation and long-term debt at exchange rates prevailing at dates acquired or assumed; and income and expenses (excluding depreciation) at average rates during the period. The exchange adjustments resulting from such translation practices are reflected in consolidated earnings.

(c) **GOODWILL**–Goodwill represents the excess of the purchase price of investments in subsidiaries and a joint venture over the Company's interest in the fair value of the net assets acquired. Of the total of $14,133,000 on the balance sheet, $3,704,000 represents goodwill with respect to investments acquired before December 31, 1973 and for which the Company has made no provision for amortization since, in the opinion of management, there has been no reduction in value. The balance, $10,429,000, representing goodwill with respect to investments made after December 31, 1973, is being amortized as required under generally accepted accounting principles adopted in Canada subsequent to 1973. The rate of amortization is 2½% per year.

(d) **PROVISION FOR BOOK RETURNS**–For accounting purposes, the Company follows the practice of making a provision for book returns determined by reference to past experience and expectations. For tax purposes, the Company and certain of its subsidiaries are not permitted to deduct the provision until the year that the books are actually returned. The amount of tax thus prepaid is carried on the balance sheet.

(e) **WITHHOLDING TAX**–Provision is made for all taxes which it is estimated will be payable on future remittances of earnings from operations outside Canada. At present, the total on which tax has been provided includes all undistributed earnings of these subsidiaries since the Company does not consider these to have been reinvested on a long-term basis.

2. Acquisition

Effective April 1, 1978, the Company acquired approximately 78% of the outstanding common shares of The Laufer Company for $10,507,000 cash. The acquisition equation of this investment, which has been accounted for as a purchase, may be summarized as follows:

Net assets acquired, at fair values:	
Net current assets	$3,142,000
Fixed assets	102,000
	3,244,000
Less minority interest	722,000
	2,522,000
Excess of cost of investment over interest in fair value of net assets (goodwill)	7,985,000
Cost	$10,507,000

In addition the Company has agreed to purchase a further 21% (250,000 shares) from certain senior officers on the basis of 50,000 shares per year during each of the next five years. The purchase price will vary with the earnings of The Laufer Company, with a minimum commitment currently of approximately $2,300,000.

3. Accounts receivable

The major items in accounts receivable at December 31 are as follows:

	1978	1977
Due from customers	$24,928,000	$14,982,000
Other receivables	1,442,000	676,000
	26,370,000	15,658,000
Less provision for returns	8,764,000	7,049,000
Net receivable	$17,606,000	$ 8,609,000

4. Fixed assets

The major categories of fixed assets at December 31, 1978 are as follows:

	Cost	Accumulated depreciation	Rates
Buildings	$ 319,000	$ 60,000	5%
Furniture, machinery and equipment	2,254,000	1,036,000	15-20%
Vehicles	574,000	161,000	25-30%
Leasehold improvements	647,000	328,000	
	3,794,000	1,585,000	
Land	85,000		
	$3,879,000	$1,585,000	

Straight-line depreciation is written on leasehold improvements over the terms of the leases, and the diminishing balance method is applied to the other depreciable assets at the rates shown in the above table.

5. Long-term debt

Long-term debt consists of:

	1978	1977
Note payable (U.S. $) with interest which is not to exceed 10% or be less than 6%, due 1979-87. Current interest rate 10%.	$ 963,000	$ 950,000
Sundry foreign currency bank loans due 1979-85. Current interest rates range from 5% to 10.25%.	3,330,000	1,221,000
	4,293,000	2,171,000
Less current portion	913,000	
	$3,380,000	$2,171,000

(a) Principal repayments on long-term debt for each of the five years following 1978 are: 1979–$913,000; 1980–$1,597,000; 1981–$1,023,000; 1982–$106,000; 1983–$106,000.

(b) Interest on long-term debt amounted to $289,000 in 1978 and $117,000 in 1977.

(c) If the long-term debt payable in foreign currencies were translated into Canadian dollars at the exchange rates in effect at the end of the year, long-term debt net of current portion would have been $4,030,000 at December 31, 1978 ($2,472,000 in 1977). It is anticipated that these borrowings will be repaid out of funds generated in the same currencies.

6. Capital stock

(a) At December 31, 1978, there were options outstanding to employees, which expire between 1983 and 1988, covering 169,800 shares (including 24,000 to an officer and director) at prices ranging from $1.20 to $12.82 per share.

Of the 450,000 common shares initially reserved for the stock option plan, 190,500 remain reserved and have not been granted.

(b) During the year, the company reserved 50,000 shares under the terms of a stock purchase plan, enabling certain officers and employees, as designated from time to time by the directors, to purchase shares from treasury at the weighted average of the closing sale price for the last ten trading days prior to the date of issue.

(c) During the year, a total of 35,205 shares were issued for a consideration of $215,000 as follows:

24,300 shares under employee stock option plan	$ 76,000
10,905 shares under stock purchase plan	139,000
35,205 shares	$215,000

7. Earnings per share

Earnings per share have been computed on the basis of the weighted average number of shares outstanding during the year. The dilutive effect of the employee options is immaterial.

8. Commitments

(a) The Company has entered into U.S. dollar foreign exchange contracts (at an average rate of $1.15 Cdn.) covering the anticipated net cash flow from U.S. operations for the coming year.

(b) The Company is committed to annual rentals of approximately $800,000 for each of the next five years.

9. Contingent liabilities

The Company is the defendant in litigation arising out of a magazine article. In the opinion of management, based in part upon discussions with counsel, the ultimate disposition of this action will not materially affect the financial position of the Company.

10. Remuneration of directors and officers

The aggregate remuneration ($23,000 of which was to directors as such) charged to consolidated earnings for the year ended December 31, 1978, in respect of fourteen directors (five of whom were also officers) and three other officers of the Company, was as follows:

By Harlequin Enterprises Limited	$1,592,000
By Mills & Boon Limited	122,000
	$1,714,000

11. Comparative information

Certain of the 1977 figures provided for purposes of comparison have been reclassified to conform with presentation adopted in the current year.

NINE-YEAR OPERATING HISTORY

	1978	1977	1976
OPERATING RESULTS ($000)			
Net revenues	**$125,866**	$80,451	$52,391
Net earnings	**16,791**	12,514	5,323
FINANCIAL POSITION ($000)			
Current assets	**$ 58,369**	$45,877	$23,605
Current liabilities	**25,215**	21,257	10,486
Working capital	**33,154**	24,620	13,119
Net fixed assets	**2,294**	1,716	1,017
Other assets	**14,133**	6,367	5,750
Other liabilities	**4,389**	2,171	527
Shareholders' equity	**45,192**	30,532	19,359
FINANCIAL RATIOS			
Net earnings on net revenues	**13.3%**	15.6%	10.2%
Net earnings on equity	**37.2%**	41.0%	27.5%
Working capital ratio	**2.3:1**	2.2:1	2.3:1
Earnings per share	**$1.06**	$ .79	$ .34
Equity per share	**$2.85**	$1.93	$1.23
Dividends per share	**$ .15**	$ .09	$ .08
OTHER DATA			
Shares outstanding (000)	**15,861**	15,826	15,793
Number of employees	**980**	881	584

1975	1974	1973	1972	1971	1970
$43,249	$30,983	$20,358	$15,277	$ 7,977	$ 7,719
4,418	3,527	2,737	1,577	454	110
$19,172	$14,288	$ 9,941	$ 6,132	$ 6,151	$ 3,631
8,377	7,043	5,061	3,396	3,679	2,098
10,795	7,245	4,880	2,736	2,472	1,533
853	716	507	201	211	229
3,704	3,704	3,741	3,867	3,933	2,152
—	—	—	—	2,275	27
15,352	11,665	9,128	6,804	4,341	3,887
10.2%	11.4%	13.4%	10.3%	5.7%	1.4%
28.8%	30.2%	30.0%	23.2%	10.5%	2.8%
2.3:1	2.0:1	2.0:1	1.8:1	1.7:1	1.7:1
$ .29	$ .24	$ .18	$ .12	$ .04	$ .01
$ .97	$ .79	$ .61	$ .46	$ .34	$ .31
$ .08	$ .07	$ .03	$ .01	—	—
15,793	14,859	14,859	14,859	12,609	12,609
332	313	240	201	157	188

HARLEQUIN ENTERPRISES LIMITED

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William F. Willson
EXECUTIVE VICE-PRESIDENT

Martin A. Reaume
CONTROLLER

Frederick C. Z. Silk
SECRETARY–TREASURER

Anthony P. L. Lloyd
DIRECTOR
CORPORATE DEVELOPMENT

DIVISIONAL MANAGEMENT

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Bernard C. J. Rogers
FINANCIAL DIRECTOR AND
COMPANY SECRETARY

Heather Jeeves
EDITORIAL DIRECTOR,
FICTION

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PUBLISHING DIRECTOR

Owen E. Bryant
U.K. MARKETING DIRECTOR

Michael N. Saraceno
PRODUCTION DIRECTOR

MILLS & BOON (Australia)

Les A. Ward
MANAGING DIRECTOR

CORA VERLAG (Germany)
(50% owned)

Klaas Koome
JOINT MANAGING DIRECTOR

Hans Sommer
JOINT MANAGING DIRECTOR

HARLEQUIN FRANCE

Christian Chalmin
MANAGING DIRECTOR

HARLEQUIN GREECE

L. R. John Rendall
MANAGING DIRECTOR

HARLEQUIN HOLLAND

Klaas Koome
MANAGING DIRECTOR

HARLEQUIN JAPAN

Henry Tamaki
MANAGING DIRECTOR

HARLEQUIN SCANDINAVIA

Staffan Wennberg
MANAGING DIRECTOR

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Harlequin Enterprises Limited
Don Mills

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Deputy Chairman
Chairman,
Mills & Boon Limited
London

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Retired Partner
Richardson Securities of Canada
Toronto

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Group Editorial Director, Fiction
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Oxford University Press
London

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and Administration
Torstar Corporation
Toronto

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Gardiner, Watson Limited
Toronto

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President
Harlequin Enterprises Limited
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BELAND H. HONDERICH
Chairman and President
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Bristol-Myers Co. Ltd.
London

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Investor and Corporate Director

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Harlequin Enterprises Limited
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KLAAS KOOME
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STAFFAN WENNBERG
Other Languages

* *The Overseas Committee has the function of advising the Board for companies operating outside North America.*

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REGISTRAR AND TRANSFER AGENT
Montreal Trust Company
Toronto, Halifax, Montreal,
Winnipeg, Calgary, Vancouver

Harlequin Enterprises Limited